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No. 811

IN THE

Supreme Court of the United States

October Term, 1958

MID-SOUTHERN FOUNDATION,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

REPLY BRIEF FOR PETITIONER IN SUPPORT OF WRIT

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REPLY BRIEF FOR PETITIONER

By opposing the writ applied for in this proceeding it seems to us that respondent has construed the meaning of Section 437(c) of the Internal Revenue Code of 1939, as amended, to be available to the Internal Revenue Service for the purpose of *eliminating*, in exceptional cases, the benefit of an Excess Profits Tax Credit, when computed upon the average base period net income of the taxpayer, as provided by Section 435(a)(1)(A), (B) and (C) of the 1939 Code.

The question of the taxpayer being subject to Excess Profits Tax is immaterial; but nothing should be done to increase the amount of such tax by improperly elimi-

nating the amount of its Excess Profits Tax Credit, as provided by Section 435 in the manner proposed by respondent.

It is quite apparent that Section 437(c) is applicable only when the Excess Profits Tax Credit *allowable* is based on invested capital, as provided by Section 436; whereas respondent concedes that Section 436 *is inapplicable to this taxpayer* for the taxable periods in question.

If it were not for the provisions of Section 435(a)(1)(A), (B) and (C) of the 1939 Code, as amended, the *deficit* appearing in the equity *invested capital structure* of taxpayer for the years 1951 and 1952, would operate to deprive it of any Excess Profits Tax Credit. In the absence of Section 435(a)(1)(A), (B) and (C), there would be no basis for the computation of an Excess Profits Tax Credit *under the provisions of Section 436*, pursuant to the provisions of Section 437(c). Section 435, which is applicable to the taxpayer in this proceeding, is in nowise dependent upon Section 437(c); and its provisions should not be restricted under the provisions of Section 437(c), as proposed by the respondent.

Equity invested capital is the sum of money, or the value of property, paid-in for capital stock, which may afterwards be adjusted—not on the basis of the appraised value of capital assets held—but rather on the basis of additional capital paid-in or withdrawn at its adjusted basis during a taxable period.

It is apparent from the language of Section 437(c) of the 1939 Code, as amended, that equity capital as of any time shall be the total of *the cost basis* of assets held in good faith for the purposes of the business of a taxpayer, *reduced by the total of liabilities*. In the event of a *deficit* there is no *invested capital* used in a business, except the amount which may be borrowed on the basis of "fair market value of assets".

For the purpose of computing equity invested capital under the provisions of Section 437(c), the amount attributable to each asset shall be determined by ascertaining the adjusted *cost basis* thereof (or, in the case of money, the amount thereof); and the *adjusted cost basis* of an asset for computing equity capital shall be the *adjusted cost basis* of an asset for determining *gain upon the sale or exchange thereof.*

Therefore, since it is a cardinal rule of the Internal Revenue Code that the *adjusted cost basis* of property for computing *gain* upon the sale or exchange thereof is never *below zero*, it would appear fallacious to construe the meaning of Section 437(c) of the Code to mean that "equity capital" of a taxpayer can be adjusted to a "negative" quantity or basis for the purpose of *reducing* the amount of Excess Profits Tax Credit, as provided by Section 435(a)(1)(A), (B) and (C) by 12% of such "negative quantity". Such negative quantity would be *increased*, by a distribution from capital rather than *decreased.*

It would appear fallacious to *increase* the amount of Excess Profits Tax Credit, as provided by Section 435, by the amount of 12% of any *increase* in "deficit capital". Therefore, the amount of such credit should not be reduced by 12% of the amount of "deficit capital" *below zero.* There is no term of art in the statute that can be used beyond the plain and economical meaning of the term "*invested capital*" as known to commerce and trade.

It is significant that Section 437(c) speaks of the *adjusted cost basis* of an asset "for determining *gain* upon sale or exchange". No mention is made of the *adjusted cost basis* of an asset "for *determining loss upon sale or exchange*". Section 437(c) should not be construed so as to make its provisions conflict with Section 435(a)(1)(A), (B) and (C) of the 1939 Code, but that appears to be the purpose of respondent.

Therefore, the respondent is undertaking to have the Court read into the provisions of Section 437(c) a meaning that is not justified by its language. (See *Smietanka* v. *First Trust & Savings Bank*, 257 US 602, 66 L. Ed. 391).

In the *Smietanka case, supra,* it is said:

> "It may be that Congress had a general intention to tax all incomes, whether for the benefit of persons living or unborn, but a general intention of this kind must be carried into language which can be reasonably construed to effect it. Otherwise the intention cannot be enforced by the courts. The provisions of such acts are not to be extended by implication. Treat v. White, 181 U.S. 264, 267, 45 L. ed. 853, 854, 21 Sup. Ct. Rep. 611; United States v. Field, 255 U.S. 257, 65 L. ed. 617, 41 Sup. Ct. Rep. 256; Gould v. Gould, 245 U.S. 151, 153, 62 L. ed. 211, 213, 38 Sup. Ct. Rep. 53."

It is hardly conceivable that Congress had any general intention that Section 437(c) of the 1939 Code, as amended, be construed—as proposed by respondent—for the purpose of eliminating entirely the benefit of an Excess Profits Tax Credit, as provided by Section 435 (a)(1)(A), (B) and (C) when an alternative method of computing the credit based on *invested capital* (Section 436) is not *applicable*. We see no purpose of the applicability of Section 437(c) to this taxpayer, except for the purpose of depriving it of the benefit of Section 435 (a)(1)(A), (B) and (C) in the computation of its Excess Profits Tax liability. There is nothing sinister or evil in the deficit structure of the *invested capital* of taxpayer for the taxable periods in question; but respondent appears to think so.

CONCLUSION

We submit that a proper and authoritative construction of Section 437(c) of the 1939 Code, rather than the strained and altogether improper construction proposed by respondent, justifies the granting of the writ applied for in this proceeding.

The decision below is not correct on any principle of constitutional law; and the question of the interdependence of the meaning of Section 435(a)(1)(A), (B) and (C), and Section 437(c) of the 1939 Code, as amended, *is of general importance.*

The question is "a narrow and highly technical one" only to the extent that it is made so by the opposition brief of respondent; and we submit that respondent's opposition should not be acquiesced in for the reasons assigned.

Respectfully submitted,

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